

Congress of the United States

Washington, DC 20515

November 16, 2018

The Honorable Linda McMahon
Administrator
United States Small Business Administration
409 3rd Street, SW
Washington, DC 20416

Administrator McMahon:

We write to express our strong objection to your proposed rule governing SBA-guaranteed loans to qualified employee trusts (employee stock ownership plans, or “ESOPs”), which you noticed on September 28, 2018.¹ Specifically, SBA is proposing to amend its regulation at 13 C.F.R. § 120.350 to prohibit applications for SBA-guaranteed loans to ESOPs for the purposes of either helping finance the growth of the business or to purchase ownership or voting control of the employer from being processed under a lender’s delegated authority.² If finalized in its proposed form, 13 C.F.R. § 120.350 would be in direct contravention of the policy enacted by Congress in Section 862 of the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (NDAA),³ which charges SBA with promoting enhanced employee ownership of ESOPs by maximizing the ability to affordably access capital. Therefore, we strongly object to the proposed regulation on the processing of ESOP loan applications, and urge that the final version of 13 C.F.R. § 120.350 be aligned with the policy embodied in Section 862 of the NDAA – allowing applications for these loans to be processed under a lender’s delegated authority.

As has been stressed to SBA recently, nearly half of all privately-held businesses in the U.S. are owned by individuals who are at or near retirement age, representing more than 2.3 million companies, and employing close to 25 million workers in total (one in six workers nationwide). Though more than half of these small business owners expect to retire within the next ten years, fewer than 15 percent have a formal exit plan in place. Only a small percentage of these businesses will be passed on to family members or bought by another local company. Instead, many of these businesses could be bought out by competitors or even close due to a lack of planning or inability to find a buyer; both of which result in damage to local communities from lost jobs and revenue.

This “baby boomer cliff” is a very real concern for the business owner who may not have enough money on which to retire, and employees of those businesses, who struggle with the uncertainty of their boss’ future retirement plans. As this trend accelerates in the coming years, it is crucial that those small business employees be empowered to transition the business to an employee-owned model, preserving the firm’s independence and protecting it from the risk of decline, buyout, or outright closure.

¹ 83 Fed. Reg. 189 (Sep. 28, 2018).

² 83 Fed. Reg. 189 (Sep. 28, 2018).

³ Pub. L. 115-232, § 862.

In order to address this issue, Congress included numerous provisions in the NDAA⁴ seeking to ease a small firm's transition to an employee-owned model. Notably, Section 862(b) expands the 7(a) loan guaranty program to ESOPs to align the program with current industry financing practices.⁵ Most importantly, though, is the provision in Section 862(b)(2), which expressly adds loans to ESOPs to the group of loans guaranteed by SBA which may be processed under a lender's delegated authority.⁶ Thus, the Congressional intent of the legislation authorizing SBA to allow for delegated authority clearly recognizes the ability of experienced lenders to process these transactions. However, the agency did not follow through with this intent and instead summarily denied such transactions from delegated authority based on the "complex nature of these transactions."⁷ Such revocation of delegated authority should be based on the lender's ability to process a transaction, not solely on the type of transaction. In fact, many of the lenders delegated with partial or full authority to approve loans are some of the most technically savvy lenders to take on the "complex nature of these transactions." Finally, with appropriate supporting documentation and requisite oversight currently in place, SBA has the necessary tools to ensure loan processing of ESOP transactions is performed properly.

It is therefore our strong recommendation that SBA amend this section of the current proposed rule. The final rule should align with this clearly-articulated intent to allow the delegation of authority for these transactions. It is of the utmost importance and a simple policy goal to encourage more and quicker lending to ESOPs, so they may affordably access capital needed to transition their businesses to an employee-owned model.

The new law was written with the intent to increase the availability of capital to ESOPs and other employee-owned models because it is clear SBA is not fulfilling its full potential in assisting new and transitioning companies. As a result, employee-owned businesses have been put at a disadvantage. It is our hope that we can work together over the coming months to ensure that SBA creates a rule that follows Congressional intent.

Sincerely,



Nydia M. Velázquez
Member of Congress



Kirsten Gillibrand
United States Senator

⁴ Pub. L. 115-232.

⁵ Pub. L. 115-232, § 862(b).

⁶ Pub. L. 115-232, § 862(b)(2).

⁷ 83 Fed. Reg. 189 (Sep. 28, 2018).